EXECUTIVE SECRETARIAT

ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				
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3	EXDIR				
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7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/OLL				
14	D/PAO				
15	VC/NIC				
16	NIO/ECON		X		
17	D/OGI		X		
18	ER				
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SUSPENSE ______________ Date

Remarks Rcvd 10/25!!

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STAT

Executive Secretary

25 OCT 85

Date

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THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 10/22/85 **Number:** 317010CA **Due By:**

Subject: Economic Policy Council Meeting -- October 24, 1985
1:00 P.M. -- Roosevelt Room

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☐
Justice	☐	☐
Interior	☐	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Chief of Staff	☑	☐
Education	☐	☐
OMB	☑	☐
CIA	☑	☐
UN	☐	☐
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
McFarlane	☑	☐
Svahn	☐	☑
Chew *(For WH Staffing)*	☑	☐
Hicks	☐	☑
Executive Secretary for:		
DPC	☐	☑
EPC	☑	☐

REMARKS:

The Economic Policy Council will meet on Thursday, October 24, at 1:00 P.M. in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☑ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☐ Rick Davis
☐ Ed Stucky

Associate Director
Office of Cabinet Affairs

DCI EXEC REG

L-300B

THE WHITE HOUSE

WASHINGTON

October 22, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER

SUBJECT: Agenda and Papers for the October 24 Meeting

The agenda and papers for the October 24 meeting of the Economic Policy Council are attached. The meeting is scheduled for 1:00 p.m. in the Roosevelt Room.

The first agenda item is the Report of the Working Group on Steel. The Working Group has prepared separate papers on two issues. The first issue is whether the Administration should raise the 1.7 million ton target for semifinished steel. The EC has indicated that the level of semifinished steel imports is crucial to acceptance of the overall U.S. - EC steel arrangement. Some U.S. steel producers are concerned that the limits on semifinished steel are too restrictive.

The second issue developed by the Working Group is what action the Administration should take if a new U.S. - EC Steel Arrangement is not concluded by October 31, the date which Secretary Baldrige and EC Commissioner De Clercq set as the deadline for negotiating a renewal of the arrangement. The Working Group has prepared several options for Council consideration.

The second agenda item is Canadian lumber. The Trade Policy Review Group has prepared a memorandum describing the issues involved with Canadian lumber imports, reviewing a recent ITC report on current conditions in the softwood lumber industry, and outlining a general Administration response. The TPRG paper is attached.

Attachments

THE WHITE HOUSE

WASHINGTON

ECONOMIC POLICY COUNCIL

October 24, 1985

1:00 p.m.

Roosevelt Room

AGENDA

1. Report of the Working Group on Steel Trade
2. Canadian Lumber

October 22, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE WORKING GROUP ON STEEL TRADE

SUBJECT: Semi-Finished Steel and the President's Program

Issue

Should the 1.7 million ton limit for imports of semi-finished steel be raised?

Background

The President's steel program set a target level of 1.7 million net tons for imports of semi-finished steel. The U.S. has allocated roughly 1.2 million tons to arrangement countries to date. If imports from the EC, Sweden, and Canada at current rates are added, semis imports would total 2.4 million tons in 1985. The annualized eight months 1985 rate is 2.4 million tons.

The EC objects to including semis in the new steel arrangement. If a limit is set, the EC would need 1.0 to 1.8 million tons. The EC exported 800,000 tons in 1984 and is likely to export about the same amount this year. A new firm, Tuscaloosa Steel in Alabama (partly owned by British Steel), may need an additional 400,000 to 600,000 tons and California Steel (CSI) claims that it would like to import several hundred thousand tons from the EC. The EC has indicated that the level agreed upon for semi-finished steel imports is crucial to the acceptance of the overall arrangement.

Raising the import limit for semis would raise an equity issue for countries with signed agreements. Brazil, Japan and other countries would press us for upward adjustments in their restraint levels so they would retain the same share of the new ceiling. The domestic industry and many in Congress would view it as a breach of the President's 1984 commitment and as a disincentive for industry modernization.

Those producers undertaking the expensive modernization of their steelmaking operation argue that the availability of dumped or subsidized semis encourages U.S. producers to forego these expensive investments. If some integrated steelmakers were allowed to import enough semis to shut down hot ends and run finishing mills off of imports, others may want to do the same, possibly changing the fundamental structure of the U.S. steel industry.

Objectives

-- To gain leverage to reach agreement with EC on terms compatible with the President's program.

-- To meet essential needs of the U.S. economy for imported semis.

-- To provide incentive to U.S. steel industry to modernize facilities and shut outmoded mills.

OPTION 1

Hold imports of semis to 1.7 million net tons per year and strictly enforce short supply provisions.

Advantages

-- Maintains Presidential commitment.

-- Provides greatest incentive for industry modernization.

Disadvantages

-- 1.7 million ton level may not be sustainable. Imports to two domestic users, Tuscaloosa and CSI could not be accommodated and/or traditional importers may be cut off from semis

-- It would be very difficult to renegotiate the EC agreement.

OPTION 2

Hold imports of semis to 1.7 million net tons per year and conduct short supply reviews based on all market factors. Based on current preliminary information, there is some possibility for an affirmative short supply decision on continuously cast thick slab (10 inches or more in thickness).

Advantages

-- May better provide for Tuscaloosa's needs.

-- Would not change 1.7 million ton target level.

-- Could facilitate a deal with the EC.

-- Avoids the equity argument about raising the ceilings for other countries.

Disadvantages

-- After EC's experience with All American Pipeline, they may lack confidence in short supply as way of meeting their needs.

-- May not fully meet Tuscaloosa's needs. May not meet CSI's needs.

-- Would affect the administration of short supply provisions under the Arrangements.

OPTION 3

Raise the ceiling on imports of semis to a higher level, in the neighborhood of 2.2 to 2.3 million tons.

Advantages

-- Would help meet the needs of CSI, Tuscaloosa, and other importers.

-- U.S. integrated producers may accept a small increase in interests of getting a deal with the EC.

-- An increase to this level should satisfy the EC.

Disadvantages

-- Would require raising 1.7 million ton level, setting off possible political reaction.

-- U.S. Steel and Bethlehem may file AD/CVD cases, which could give grounds for terminating arrangements.

-- Current VRA countries may press for higher quotas on equity grounds..

-- To the extent EC is aware of approved ceiling it becomes minimum expectation.

OPTION 4

Postpone the decision on raising semis target until results of the EC negotiations are known. Authorize U.S. negotiators to reach ad referendum agreement with EC, subject to EPC review, that provides for limited increase in semis imports, taking into account essential needs of U.S. economy, need to provide incentive to U.S. steel industry to modernize, and interests of other semis suppliers.

The Working Group recommends that the Administration adopt this option because deciding now on a specific number may harm our negotiating leverage, although the Working Group unanimously agrees that we will have to exceed the 1.7 million ton target in order to conclude an arrangement with EC.

Advantages

-- Would help meet the needs of CSI, Tuscaloosa and other importers.

-- U.S. integrated producers may accept a small increase in interests of getting a deal with the EC.

-- Could meet EC needs.

-- If EC became aware of EPC action, it would not know how high U.S. is willing to go, increasing leverage of negotiators.

Disadvantages

-- Would require raising 1.7 million ton level, setting off possible political opposition.

-- U.S. Steel and Bethlehem may file AD/CVD cases, which could give grounds for terminating arrangements.

-- Current VRA countries may press for higher quotas on equity grounds.

-- Failure to quantify new semis target could encourage EC to make exorbitant demands.

OPTION 5

Tariff-rate quota (TRQ) at 1.7 million tons or some marginally higher level.

Advantages

-- Semis tonnages in existing arrangements and a renegotiated EC arrangement could be allowed entry duty-free.

-- If tariff set at 20 percent or $50 per net ton, it would largely offset price advantage of imported semis.

-- Could avoid equity argument.

-- Would permit supplier nations, such as Brazil, to sell more semis if importers paid additional duties.

Disadvantages

-- Greatly increased semis imports could undermine the President's program by encouraging U.S. firms to forego modernizations by importing semis. Firms involved in modernization and Congressional interests seeking incentives for modernization would be strongly opposed.

-- Some countries may demand compensation or retaliate if the U.S. imposes higher tariffs on semis imports.

-- Could make agreement with EC more difficult.

-- Those bringing in semis last pay duty. A rush to enter early in each quota period would occur. Hard for users to plan on availability at a set price.

-- President would need legal authority to impose a TRQ.

-- May reduce competitiveness of semis importers who could face higher import prices.

-- Given history of unfair trade and duty absorption, the tariff may have little effect.

October 22, 1985

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE WORKING GROUP ON STEEL TRADE

SUBJECT: U.S.-EC Steel Negotiations: Options for Unilateral Action

Issue

What action should the Administration take if a new U.S.-EC steel arrangement is not concluded by October 31?

Background

In 1982, the Commerce Department found that several EC countries subsidized or dumped steel in the United States. An arrangement was negotiated at the EC's request as an alternative to the imposition of offsetting duties. Many EC producers remain vulnerable to the unfair trade findings.

In June of this year, Secretary Baldrige and EC Commissioner De Clercq exchanged letters setting an October 31 deadline to negotiate a renewal of the 1982 Arrangement, which expires on December 31, 1985, and of the Complementary Products Arrangement, which expires on December 31, 1986. As part of this agreement, Secretary Baldrige authorized 100,000 tons of special issue licenses for the All American Pipeline on the condition that the October 31 deadline be met. This tonnage will be counted against the EC's 1986 pipe and tube allocation if no agreement is reached by October 31. Three rounds of negotiations on the renewal arrangement have been held so far, and a fourth round will begin in Brussels on October 23.

The U.S. is seeking a comprehensive steel arrangement consistent with the President's program, extending through September 30, 1989. The EC has proposed raising restraint levels for products now subject to licensing and has resisted an extension past December 31, 1987. At this time, the EC objects to restraining exports of semi-finished steel to the U.S.

Steel imports continue at very high levels. Import penetration through the first eight months of 1985 remains in excess of 25%, well above the expected 18.5% announced by the President in September 1984. The EC is primarily responsible for this problem. Comparing the first eight months of 1985 to the same period of 1984 shows that the EC has increased 17%, while Japan has declined 4%, Canada 10%, and all others 18%.

Objectives

-- To gain leverage to achieve restraint levels that are consistent with the President's program and that offset effects of the EC's unfair trade practices.

-- To gain leverage to comply with the October 31 deadline agreed to by both sides.

Options

The Working Group has identified several options for meeting these objectives. The Administration could choose one or more of these options. Irrespective of which option is chosen, the Administration should count the 100,000 tons of line pipe against the EC's pipe and tube allocation.

OPTION 1

On November 15, suspend immediate delivery privileges for EC steel imports under restraints due to expire on December 31, 1985. EC allocations for 1985 are filling and there is no future restraint period against which to issue licenses. Since EC exporters may attempt to enter excessive quantities, this measure would be taken solely for the purpose of ensuring that EC allocations are not exceeded.

Advantages

-- Ensures EC ceilings for 1985 are not exceeded.

-- Provides incentive for the EC to conclude agreement quickly.

-- Demonstrates to the EC, the domestic industry, and Congress our seriousness about enforcing these arrangements without giving the EC justification for terminating them.

-- Allows an additional two weeks to negotiate after the October 31 deadline.

Disadvantages

-- May adversely affect U.S. consumers if there are lengthy delays.

-- Legality may be challenged.

OPTION 2

Announce that the U.S. will take action unilaterally on January 1 to control EC exports if no new arrangement is in place by that date. In anticipation of such action, announce that the Commerce Department will undertake an assessment of EC vulnerability to unfair trade cases.

Advantages

-- Sends EC a message that they will not be given free access to the U.S. market when the current arrangement expires.

-- Use of unfair trade laws prevents surge if restraints expire.

-- Satisfies concerns of U.S. industry.

-- EC is faced with a clear choice between unilateral action and negotiated levels.

Disadvantages

-- Gives the EC a pretext for terminating arrangements.

-- EC would object to negotiating under threat.

-- U.S. would be forced to act if no deal by December 31.

OPTION 3

Combine Options 1 and 2 as a package of actions that would send a strong message of the Administration's commitment to enforcing the President's steel program and that would provide strong incentive for the EC to quickly conclude an arrangement.

The Working Group recommends that the Administration pursue Option 3, which would show its commitment to the President's Steel Program and the need to achieve a quick conclusion to negotiations of a new steel agreement with the EC.

Advantages

-- Ensures EC ceilings for 1985 not exceeded.

-- Provides strong incentive for the EC to conclude agreement quickly.

-- Satisfies concerns of U.S. industry and Congress.

-- Sends EC a message that EC will not be given free access to U.S. market.

-- Demonstrates seriousness of U.S. commitment to enforcing the President's steel program.

Disadvantages

-- May adversely affect U.S. consumers if there are lengthy delays entering steel.

-- Gives the EC pretext for terminating the arrangements.

-- EC would object to negotiating under threat.

-- U.S. would be forced to act if no deal by December 31.

OPTION 4

Self-initiate and impose 301 remedy and/or initiate AD/CVD cases on or shortly after November 1.

Advantages

-- Affirms U.S. commitment to President's program and October 31 deadline. Strongly supported by industry, labor, and their allies in Congress.

-- As in 1982, France, Italy, UK, and Belgium are more vulnerable to AD/CVD cases than West Germany and the Netherlands, a politically unacceptable situation within the Community, which would force the EC to conclude a negotiated solution.

-- 301 quotas on EC prevent any potential surges resulting from the termination of the arrangements.

-- Unilateral action may be necessary to achieve agreement here as happened with the embargo on pipe and tube and the January 1985 accord on pipe and tube, and the clear intention of the U.S. to act on consultation products and the Complementary Products Arrangement.

Disadvantages

-- EC would terminate all arrangements including the Pipe and Tube Arrangement and may retaliate against 301 action.

-- Could disrupt trade and cause uncertainty for U.S. consumers.

-- Could hurt the negotiations. Acting on November 1 may be viewed as premature with two months remaining in 1985 to work out an agreement, particularly if we appear to be close to reaching a deal.

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

October 22, 1985

MEMORANDUM

To: Economic Policy Council

From: Ambassador Yeutter CY

Subject: Canadian Softwood Lumber Imports

Summary

U.S. lumber mills are under economic stress, particularly along the Canadian border and throughout much of the South. They are blaming Canada for their ills, and are pressing strongly for either legislative or administrative action against the Canadians. The U.S. firms argue that they are more efficient than their Canadian counterparts, but cannot compete because Canadian provinces deliberately underprice (in essence, subsidize) their timber. Canada, on the other hand, argues that their mills are competitive and that as a sovereign nation they can price their timber any way they wish.

This memorandum describes the issue and recent developments regarding it, and reports tentative inter-agency consensus that we should pursue a negotiated rather than unilateral solution. (Other options are attached at Appendix A.) The object of the October 24 EPC meeting is to discuss the issues, not necessarily to agree on an option. If we decide to negotiate, a message to the Canadians must be delivered at the highest possible political level to enhance the possibilities for successful negotiations.

The ITC Report

On March 6, 1985, we asked the International Trade Commission to examine current conditions in the softwood lumber industry. The findings of that agency were released this past week. The report is factual, and does not offer recommendations for action.

The USITC report confirms the U.S. industry's key claim, that they must pay the United States Government approximately ten times as much for standing timber on U.S. public lands as their Canadian counterparts pay the Canadian provinces (which own most Canadian forest lands). From 1982 to 1984, U.S. "stumpage"

prices increased about $10 to $104.16 (per thousand board feet), while Canadian prices increased only about $1 to $11.84. The report further notes that British Columbia, which currently accounts for 64 percent of Canadian timber harvested, provides a 10 to 30 percent allowance for profit and risk in their stumpage calculations while the U.S. Forest Service system allows only 9 to 18 percent. This is clearly advantageous to the Canadian mills. The report also confirms that import penetration by Canadian softwood lumber in our market has reached 29 percent, a significant level though up only from 28 percent in 1982.

On the other hand, the report also provides facts favorable to the Canadians. It found that labor productivity at Canadian mills is 60 percent higher than at U.S. mills. However, the ITC is reviewing this issue, since it used Canadian estimates of the number of U.S. jobs based upon Bureau of Labor Statistics figures, which exceed U.S. employment reflected in Census data by about 15,000 jobs. Moreover, there is a dispute concerning both Census and BLS data over another 30,000-36,000 jobs. U.S. worker-productivity would be much higher than originally calculated if the number of U.S. workers used in the denominator were lower. In any event, the report shows that value added per production worker-hour was more in the U.S. in 1982 than in Canada.

The Canadian advantage in stumpage rates (and perhaps labor productivity) is partially offset by U.S. advantages in lower harvesting costs for the timber, and much lower transportation costs in moving the timber to the mills. So the difference in overall variable costs is not great, but it does tilt in Canada's favor. (A chart at Appendix B lists U.S. and Canadian variable costs.)

Congressional Concern and Administration Response

U.S. lumber mills brought a subsidy case against the Canadians a couple of years ago, but the Commerce Department held that Canadian stumpage practices are not a subsidy under U.S. law. A summary of Commerce's Canadian lumber decision is included at Appendix C. Since then many Members of Congress have been pressing for legislation that would change the subsidy definition to encompass the Canadian practices. This has become a major political issue with at least 50 Members with substantial timber interests in their states, including Senators Packwood, Symms, McClure and Baucus, Congressman Craig and others. It is not one that the Administration can ignore now that the USITC report is out. The House Trade Subcommittee is scheduled to mark up the Gibbons natural resources bill on Thursday, October 24, 1985.

How we treat the Canadian lumber issue will also have implications for the issue of natural resource pricing generally, i.e., the practice of some countries (e.g., Mexico) to price natural resources for domestic consumption at below the price that a willing buyer would pay a willing seller in a free market without governmental controls.

The fundamental issue is whether the U.S. government should consider the pricing practices by the Canadians, Mexicans and others to be "unfair." I suggest we consider the following factors in addressing that issue:

<u>Reasons Why Practices Could be Considered Unfair (Although Not Necessarily Countervailable Subsidies)</u>

-- Under these practices, governments that own natural resources do not necessarily act to maximize longterm profits, as a private owner presumably would. When this occurs, noncommercial considerations may lower production costs vis-a-vis countries where the market alone determines input prices.

-- Where foreigners are not permitted to purchase the natural resources on similar terms, this creates an artificial advantage for downstream industries of the natural resource rich country.

-- In some cases, foreigners are not allowed to invest in the natural resource industries of the country concerned (<u>e.g.</u>, Mexico).

-- In some cases, foreigners are not allowed to buy the natural resources on similar terms (<u>e.g.</u>, Mexico).

-- In some cases, foreigners are allowed to buy the natural resources on similar terms, but not to export them without local processing (<u>e.g.</u>, Canada because of its export ban on logs -- similar to the log export ban in U.S. West).

-- In some cases, foreigners are not prohibited from buying the natural resources, but their transport is uneconomical (<u>e.g.</u>, natural gas from Saudi Arabia and Trinidad and Tobago).

-- In this case, British Columbia allows 10 to 30 percent for profit and risk in their stumpage calculations whereas the U.S. Forestry Service allows only 9 to 18 percent.

<u>Reasons Why Practices Should Not Be Considered Unfair</u>

-- For years the U.S. regulated its prices for natural resource products (and controlled exports of naptha), and argued to the EC that this practice was not a subsidy since its benefits were widespread (in the context of European complaints about U.S. synthetic fiber products made using price-controlled natural gas and imported into the EC).

-- Dual-pricing and "natural resource subsidy" practices aside, in some situations foreign producers may retain an underlying comparative advantage in resource-intensive production. For example, Saudi Arabian and Mexican producers could have an underlying comparative advantage in the production of certain energy-intensive products as a result of their access to abundant hydrocarbon resources.

-- Arguably the U.S. does not charge the full commercial cost for natural resource products or services it makes available, such as irrigation water or hydroelectric power. In this area, governments frequently do not act as profit-maximizers.

-- Currently there is no international consensus that these practices are either subsidies or unfair. U.S. unilateral action declaring them so, especially under the countervailing duty law, would undermine international support for the agreed international rules.

-- For many natural resources products (e.g., oil), there is no freely determined market price because of distortive cartel activity (e.g., OPEC).

-- Advantageous use by the LDC's of their natural resources is the engine for their industrialization, economic growth and increased debt-servicing capabilities.

-- Government ownership of natural resources is widespread (especially among LDC's), and declaring certain pricing practices as unfair would be regarded an intrusion into their domestic sovereignty.

-- In some cases, foreigners are allowed to invest in the natural resource and downstream industries in the country concerned (e.g., Saudi Arabia).

-- In some cases, foreigners may buy natural resoures on similar terms (e.g., Canada).

-- In some cases, foreigners are not prohibited from buying natural resources on similar terms; such purchases are simply uneconomical (e.g., Saudi Arabia, Trinidad and Tobago).

Inter-Agency Views

Appendix A sets forth options for resolving this issue, along with arguments for and against each option. The Trade Policy Review Group generally favors pursuing a less severe option, such as

negotiating with the Canadians to obtain elimination of their ban on the exportation of unprocessed logs, their adoption of satisfactory plywood standards, and reduction of Canadian tariffs on imports of U.S. finished wood products. Successful negotiations will depend on how seriously the Canadians view the threat to them from pending legislation. Avoidance of such legislation depends on how much steam is behind it and how much credibility negotiations have on the Hill.

Appendix A

Options for Resolving the Stumpage Issue

Option 1. Negotiate with the Canadians to obtain elimination of their export ban on unprocessed logs, their adoption of satisfactory plywood standards, and reduction of Canadian tariffs on imports of U.S. finished wood products.

Pros

- o Uses leverage of Canada's desire to negotiate a free trade agreement.
- o Does not require compensation to Canada for unilateral action.
- o Is not protectionist.

Cons

- o May not be a sufficiently imminent or credible solution to prevent possible enactment of a legislative solution.
- o Is likely to result in an acceptable deal only if Canada feels seriously and imminently threatened by pending legislation.
- o Unless we allow the Canadians access to our timber on federal lands, is hypocritical to press them to eliminate their export ban.

Option 2.

2(a) Pursue relief under Section 201, either by encouraging the industry to file a petition or by ourselves asking the ITC to do an investigation.

2(b) This option could include a commitment in advance that the Administration will provide relief if injury is found (possibly conditioned upon Congressional approval of necessary compensation*), and a commitment to pursue a longer term solution in the free trade area discussions or new round of trade negotiations.

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* Congressional approval of compensation -- through a resolution or a bill -- is not required, since Section 123 of the Trade Act of 1974 authorizes it in escape clause cases. It could be required in this option as a policy rather than a legal matter.

Pros

- o If the Commission finds no injury, undermines argument that relief for the U.S. industry is merited.
- o If the ITC finds injury and relief is provided, conforms with our international obligations.
- o If relief is conditioned upon Congressional approval of compensation, forces the Congress to share responsibility for the adverse trade effects of protecting U.S. industries.
- o Demonstrates Administration leadership and initiative.
- o May stave off a legislative solution if the industry believes it can prevail at the ITC.
- o Provides possibilities of both short- and long-term relief.

Cons

- o Is not a traditional escape clause case, since Canadian stumpage practices are not a temporary development to which the U.S. industry can adjust.
- o If the Administration provides relief, requires compensation on trade in $2 billion of imports, which the Congress will be reluctant to pay since many consider the Canadian practices unfair.
- o Is difficult to provide sufficient compensation, and could trigger a trade war with Canada and sink all hopes of free trade area negotiations.
- o Paints our Republican free trade friends who favor stumpage relief into a corner, if we require them to support relief for their constituents while approving compensation adverse to other members' constituent interests.
- o If self-initiated or accompanied by advance Executive Branch agreement to provide relief, could lead to requests by other industries for similar treatment.

Option 3. Encourage industry to file a Section 301 petition.

Pros

- o Shows some Administration leadership and initiative.

- Is likely to stave off legislative action if we can persuade the industry and the Congress of our willingness to provide meaningful relief.

- Reflects that there are unfair trade practices that are not countervailable subsidies, in which category these stumpage practices may fall.

Cons

- Since Commerce found the stumpage practices not to be a countervailable subsidy, may be considered an action inconsistent with our international obligations.

- Is likely to jeopardize free trade agreement discussions.

- May subject our own practices to attack.

- May not be achievable, since the industry is currently feeling bullish on its prospects for speedier legislative relief.

Option 4. Support legislation that gives us one year to negotiate with the Canadians, after which a legislated solution for stumpage only (not natural resources in general) would take effect unless the Congress gave fast track approval to a bill reporting the negotiated solution.

Pros

- Buys some time to seek a negotiated solution.

- Demonstrates Administration leadership and initiative.

- Forestalls other legislative proposals that would not allow us even the opportunity for negotiations.

- Gives the Canadians a chance to avoid less palatable, unilateral U.S. action.

Cons

- Is likely to result in legislated relief, since prospects for negotiating a solution within a year are dim.

- Forces Canada to negotiate with a gun at its head.

- May not be achievable, since industry is currently feeling bullish on its prospects for speedier relief.

- Opens up larger natural resource issue. May be difficult to limit the legislation to lumber, particularly in light of Chairman Gibbons' interest.

- Canadians would likely demand compensation if the legislated solution is implemented or retaliate if no compensation is provided.

- May subject U.S. practices to attack when our trading partners enact mirror legislation.

Option 5. Encourage industry to refile a CVD case, indicating that application of 1984 upstream subsidies provision* could yield a different result.

Pros

- Does not require compensation, since the imposition of countervailing duties is allowed by the GATT without compensation.

- Can be packaged as entirely consistent with the Administration's free and fair trade principles.

- Would likely stave off protectionist legislation, provided Commerce sends sufficiently favorable signals to assure the industry that stumpage would be found to be a countervailable subsidy this time.

Cons

- Would be challenged by the Canadians as a disingenuous, unfriendly use of the allegedly nonpolitical countervailing duty law, under which they received a clean bill of health just two years ago.

- Is likely to trigger a trade war with Canada and to scuttle FTA discussions, because GOC will be incensed at Commerce's reversal and our attempt to resolve this issue under a statute branding their practices as unfair and not requiring compensation.

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* The Trade and Tariff Act of 1984 clarifies that upstream subsidies may be countervailed on downstream products if they provide a competitive benefit and are significant. However, it did not change the basic definition of a subsidy.

- In order to send a sufficiently favorable signal to the industry, would appear to undermine the strict impartiality with which the countervailing duty law has been administered.

Option 6. Change the U.S. Forest Service's timber pricing and supply practices. This economic implications of this approach need to be explored in greater detail to determine whether it is feasible.

Pros

- Does not require compensation.
- Recognizes U.S. contribution to U.S. industry's problem.
- Enhances U.S. credibility with trading partners, by addressing this problem internally rather than seeking an external scrapegoat.
- Reduces likelihood of having to bail out timber industry again, as in 1984 (in the Timber Contract Relief Act).

Cons

- Does nothing to help the timber industry in the South, where the bulk of the timber is privately owned. Indeed, by improving situation in U.S. West, while leaving Canadian practices unchanged, may exacerbate Southern timber problems. Southern timber producers could find themselves being undercut by cheap Forest Service timber as well as by Canadian imports.
- Reduces USG revenues unless supply is increased enough to offset lower prices.
- Will be opposed strongly by environmentalists if supply is increased.

Aggregate Variable Costs to Produce Softwood Lumber (1984)

	U.S.	Canada
Delivered wood costs (stumpage, harvesting & hauling)	$156 [1]	$128 [2]
Wages	81	65
Fuel & energy	9	11
Other (work contracted out to others, products bought & resold in the same condition, glues & packaging, operating & maintenance expenses)	25	33
Subtotal	271	237
Less residual unit value (chips, waste & bark)	-58	-32
Total aggregate variable costs, less residual unit values	213	205

difference = $8

[1]Includes average U.S. stumpage price of U.S. $104.16.
[2]Includes average Canadian stumpage price of U.S. $11.84

Summary of Commerce's 1983 Countervailing Duty Investigations

In 1982 the International Trade Commission (ITC) issued a factual study of conditions in the U.S. softwood lumber industry at the Senate Finance Committee's request. A coalition of lumber producers then filed a countervailing duty petition covering lumber, shakes and shingles, and fence from Canada.

In a controversial decision in 1983, Commerce found no countervailable subsidies as a result of provincial stumpage practices. First, Commerce found that Canadian stumpage practices did not benefit only an industry or group of industries (and thus did not satisfy the "specificity test"). They determined that the availability of stumpage on equal terms without governmental restriction, coupled with sufficiently widespread harvesting by various industries, precluded an affirmative determination.

Second, Commerce found that even if the stumpage practices had benefitted a specific group of industries, they were not a subsidy as defined in the U.S. countervailing duty law. The provinces did not offer stumpage on preferential terms, and therefore did not trigger the subsection covering preferential provision of goods and services. Commerce ruled that the clear applicability of that subsection precluded application of any other subsection (even though the list is illustrative).

Commerce then ruled that even if more than one subsection of the countervailing duty law did apply, stumpage practices were not a subsidy under the other possibly relevant subsection covering the assumption of manufacturing costs. The provinces did not assume costs, they imposed them. Nor did they relieve the harvesters of any pre-existing legal liabilities (a narrow, technical interpretation of the term "assumption"). Commerce then noted that the residual valuation system used by both British Columbia (which accounts for the vast majority of Canadian stumpage harvested) and the U.S. Forest Service was reasonable. Finally, it noted that information in the record of the investigation supported the view that the Canadian stumpage prices would actually equal or possibly exceed U.S. stumpage prices if adjusted for differences in climate, terrain, species, and accessibility.

Commerce found only *de minimis* subsidies in its investigations, and consequently made negative determinations.

Today there is substantial sentiment that the harvesters of stumpage *do* constitute a specific group of industries (and thus that the specificity test is satisfied). There is also wide support for the proposition that the absence of preferential treatment within the producing/exporting country alone should not

exonerate a practice from being considered a subsidy. *

Moreover, attorneys for the U.S. industry have argued that the upstream subsidies provision enacted in the Trade and Tariff Act of 1984 could lead to a different outcome in a new case. While the upstream subsidies provision might facilitate a reversal for Commerce on the specificity test, it does not clearly lead to a decision that the stumpage practices confer a subsidy. Therefore, the key issue remains unresolved: whether the provincial stumpage practices are not only different from those in the U.S. and unfair, but constitute a subsidy within the meaning of the U.S. countervailing duty law and the GATT Subsidies Code.

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* In this connection, the Court of International Trade recently remanded to Commerce its decision in 1983 on carbon black in Mexico. While the court's ruling does not necessarily require a different outcome, it does require Commerce to focus on the _de facto_ accrual of benefits apparently without any regard for their nominal general availability. It also precludes Commerce from exonerating a practice from being a subsidy simply because it involves provision of a good or service on non-preferential terms. The court noted that pricing goods at below market rates could be a subsidy if there were insufficient economic justification for the rates.